

REPORT OF ACCOMPLISHMENTS

1995 – 1998

“PROTECTING CALIFORNIA’S CONSUMERS”

IMPROVED INSURANCE MARKET

The availability and cost of insurance coverage affect virtually all California consumers. A prime example is that no lender will make a home loan without homeowner’s insurance. The average consumer typically expects insurance premiums to steadily rise, as is often the trend of most products we purchase. However, a top CDI priority has been to reverse this trend of ever-increasing premiums by stimulating competition in the California insurance marketplace and, where necessary, offer regulatory assistance to bolster deficient insurance markets.

Restored Stability in the Homeowner’s Insurance Market

CDI’s response to past failing homeowner’s and earthquake insurance markets demonstrates that a regulator can provide effective solutions when the private sector is unable to do so. After the 1994 Northridge earthquake capsized the homeowner’s and earthquake insurance markets, CDI stepped in with innovative proposals – most notably, the creation of the *California Earthquake Authority* – to stabilize those markets. CDI’s innovation and leadership helped to ensure that tens of thousands of Californians were once again able to obtain homeowner’s and earthquake insurance policies in the wake of the crisis.

Stabilized the Earthquake Insurance Market

The “American dream” of home ownership turned into a nightmare for many Californians during the mid-1990’s. A string of major earthquakes, most notably the Northridge earthquake in 1994, sent shock waves through companies that provide homeowner’s insurance. Insurers, suddenly facing billions of dollars in claims, became wary of writing new policies, especially since California law mandates that insurers offering homeowner’s policies are required to offer residential earthquake coverage with no underwriting restrictions.¹ This mandate made homeowner’s policies too costly to underwrite and insurers, in turn, began drastically

reducing the number of new homeowner’s insurance policies. But, the insurers’ shyness from the homeowner’s market did not stop there. Insuring the high-risk, earthquake-prone regions of the Los Angeles Basin and the San Francisco Bay Area placed such an excessive financial liability on insurers that they were unable to renew many existing customer’s policies, leaving a rapidly increasing number of homeowners without any protection from risk. At the height of the crisis in the summer of 1996, 95% of the homeowner’s market had either stopped completely or severely restricted the writing of new homeowners insurance.²

Although insurers could not refuse to provide unrestricted earthquake coverage, they could establish more restrictive qualifying underwriting requirements on homeowner’s and dwelling fire insurance for new business and renewals. Additionally, they could limit the number of new homeowner and dwelling fire policies written.³

As a result, most insurers who wrote residential property insurance in California either placed more restrictive qualifying underwriting requirements on their homeowner and dwelling fire business and/or they limited the number of policies and amount of business written. Underwriting restrictions included such criteria as:⁴

- Homes could not be within x number of miles of an earthquake fault line.
- A home’s dwelling value could not exceed x amount of dollars.
- No coverage for homes made of brick or masonry construction.
- No coverage for dwellings with open foundations.
- No coverage for dwellings built on hillsides or slopes exceeding x degrees.

² SB 395 (Chapter 899/Oct. 1995)

³ California Department of Insurance, Rate Regulation Branch, memorandum dated March 22, 1999.

⁴ California Department of Insurance, Rate Regulation Branch, memorandum dated March 22, 1999.

¹ California Insurance Code Section 10081

- No coverage for homes exceeding two stories in height.
- No coverage for homes built prior to 1950, unless they had been retrofitted.
- No concentration of multiple dwellings within a specified geographic area.
- No coverage for homes in areas with limited accessibility.

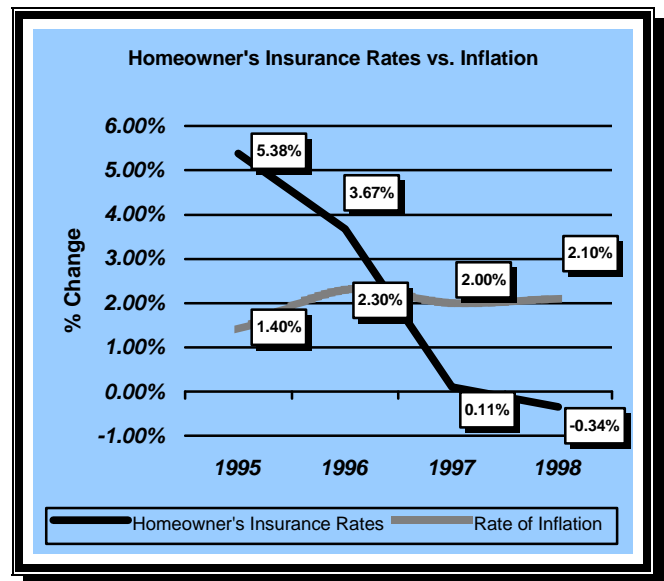
These restrictions or limitations created a severe shortage of coverage availability in the residential dwelling marketplace. CDI took several significant steps to re-establish the availability and affordability of homeowner insurance for California's consumers. For example, CDI began working with insurance companies to encourage them to remove these restrictions from homeowner insurance policies and write homeowner's policies without restrictions.

Since 1995, the number of insurance companies writing homeowner's insurance with restrictions dropped from a high of 82 in July 1996 to a low of three in October 1997. During this same period, the number of companies writing without restrictions increased from a low of four companies to 107 companies.

In a significant trend reversal, the number of complaints from homeowners who could not find homeowner's insurance dropped from 3,000 calls per month to less than 200 calls per month at the end of 1998, a 1500% decrease.⁵ This remarkable turnaround in the availability of homeowner's insurance ensures that home-buyers can close escrow and professionals such as realtors, mortgage bankers, and the construction industry can continue to provide sound economic growth.

CDI not only helped make homeowner insurance more available, the Department also addressed the serious concern that homeowner insurance had become unaffordable. During the period of 1995 to 1998, rising homeowner's insurance premiums slowed and dropped to less than the rate of inflation. Exhibit 8 contains an analysis of homeowner's insurance rates compared to inflation.

Exhibit 8: Homeowner's Insurance Rates Compared vs. Inflation, 95-98



Source: CDI Rate Regulation Branch, March 1999.
Note: 1998 figures are estimates as 1998 premium data.

In 1998, CDI began providing consumers with the ability to conduct comparative shopping for homeowner's insurance either by calling CDI's Consumer Hotline or accessing the information directly through CDI's Web Site.

The Cutting Edge - California Earthquake Authority

The successful rehabilitation of the homeowner's insurance market was due, in large part, to the CDI's efforts to restore the integrity of the earthquake insurance marketplace. Restoring the earthquake insurance market was not only a vital part of protecting Californians in earthquake-prone areas; it was essential to restoring the homeowner's insurance market as a whole.

In July 1995, CDI proposed the formation of the California Earthquake Authority (CEA), a multi-billion dollar, government administered, but privately funded earthquake insurance pool. The concept was unique; in addition to the revenue collected on limited coverage earthquake policies, the CEA would pool funding from participating insurers, reinsurance, and other forms of financial commitments for the expressed purpose of protecting California's homeowners from the risk of earthquakes.

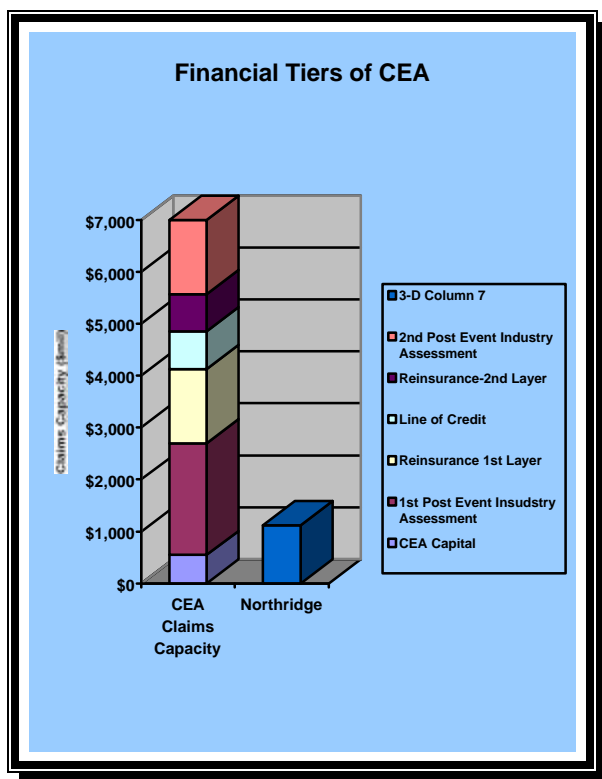
The story is one of remarkable success. By October 1, 1997, the CEA had the capacity to handle earthquake claims totaling approximately \$6.9 billion. To put this capacity in perspective, if a Northridge-type earthquake were to have occurred on October 1, 1997 the estimated loss to the CEA would have been approximately \$1.1 billion (see Exhibit 9).

⁵ California Department of Insurance, Consumer Services and Market Conduct Branch, 1998.

The CEA is now the largest earthquake insurer in the state, making earthquake insurance available for over 700,000 policyholders. The CEA is also required to take all applicants seeking earthquake insurance, thus eliminating a consumers' inability to purchase earthquake coverage.

Since the inception of the CEA, improved science and earthquake forecasting tools have led to better earthquake rating methodologies. During the CEA's first year of existence, CDI became aware of premium overcharges that averaged 11% statewide. In May 1998, CDI announced an 11% rate reduction had been approved that prompted refunds for CEA policyholders that resulted in total savings of \$37.5 million for 650,000 California homeowners.⁶

Exhibit 9: Financial Tiers of CEA



Source: CEA (As of 10/1/1997)

In December 1998, CDI approved an additional 4.5% rate reduction filing submitted by the CEA.⁷ This rate reduction was the result of the CEA's most recent scientific study and actuarial review of earthquake coverage that led to the development of further refined rating factors and adjustments to the CEA's rate setting methodologies. CDI has encouraged the CEA to continue in its efforts to make rate setting as scientifically based and financially sound as possible, thereby ensuring that the CEA's current 700,000-plus policyholders receive the best value and service possible.

⁶ California Department of Insurance Press Release, #172, for release December 4, 1998.

⁷ California Department of Insurance Press Release #182, for release December 17, 1998.

Earthquake Wrap-Around Policies

Following enactment of the CEA, CDI has worked to approve private sector insurers to offer supplementary earthquake coverage. So far, CDI has licensed two stand-alone private earthquake insurers to offer consumers more coverage than the single policy available from the CEA. These companies offer lower deductibles and expanded coverage over the CEA's policy and consumers can choose to supplement the CEA with coverage from these companies.

Earthquake Grants and Loans Program

In the interest of earthquake prevention, CDI has initiated an *Earthquake Grants and Loans Program* for low and moderate-income homeowners to retrofit their homes and make them safer in the event of an earthquake. The program was piloted successfully in Los Angeles, Humboldt, and Alameda counties and has been expanded to San Francisco, Santa Cruz, San Bernardino, Mendocino, and San Diego counties. The low-interest loans and grant funds can be used for a variety of earthquake retrofit projects, including:

- Bolting homes to their foundations.
- Strengthening cripple walls.
- Anchoring hot water heaters.
- Installing automatic gas shut-off valves.
- Installing earthquake resistant bracing systems for mobile homes.

The existence of preventive programs, such as the *Earthquake Grants and Loans Program*, benefits insurance rates in California by reducing the number of claims and the severity of claims and ultimately leading to a reduction in rates.

Earthquake Claims Mediation Program

CDI also instituted the *California Earthquake Claims Mediation Program* to provide a neutral forum for insurers and insureds to resolve disputed claims. Under the program, both parties voluntarily enter into the mediation program. After only six months in operation, the mediation program enabled consumers to receive nearly \$7 million in claims payments that were disputed.⁸

Broadened Access to Health Insurance

The availability of health care insurance is a major concern of many Californians. In January 1995, CDI went to work to help small business owners and their employees obtain

inexpensive health care coverage and make that coverage more portable. CDI is also helping seniors obtain long-term care insurance coverage.

Small Business COBRA's

CDI sponsored AB 2659 (1998), legislation to extend protection from the Consolidated Omnibus Reconciliation Act (COBRA) to employees of companies with two to 19 employees. This law allows employees of these small businesses to have the same health care protections as employees in larger companies. Such protection provides employees in nearly all California businesses with the security of being able to continue their group health insurance policy for up to 18 months while transitioning to another employer's health plan.

Advocating Multiple, Competing HIPC's

CDI continues to seek legislation to allow private sector competition with the state's Health Insurance Plan of California (HIPC). Under current law, the HIPC allows the state's small business employers to join together to negotiate for better health insurance premiums with insurers and HMO's. Like a number of other states, California had enacted legislation creating health care purchasing alliances to benefit small businesses.

CDI is seeking to allow private entities to perform the same function as the state HIPC, which would increase the bargaining power of small employers and ultimately enable more employers to provide quality health insurance coverage for their employees. While these legislative efforts have not yet been successful, CDI will continue to explore alternatives that empower small employers to negotiate better health insurance premiums.

Created Tax-Qualified Long-term care Policies in California

CDI worked to ensure that seniors had more opportunity to obtain long-term care insurance. Two years ago, the United States Congress authorized the sale of long-term care policies offering significant tax benefits. In 1997, CDI worked with the California State Legislature to modify California law to comply with Federal law and allow the sale of these tax-qualified products while ensuring that consumers still had the option to purchase non-tax-qualified products if they choose.

CDI has processed and approved long-term care filings from over a dozen long-term care insurers and now seniors have more choices for this type of insurance than ever before. CDI has made long-term care policy review a top priority of the Department's *Policy Approval Bureau* and CDI is strongly committed to increasing the availability and

⁸ California Department of Insurance, Consumer Services Division and Market Conduct Branch, May 26, 1999.

affordability of these new policies in the marketplace. As of February 23, 1999, CDI had received 327 filings from 49 companies, and 203 policies have been approved.⁹

Reducing Consumers' Dependence on "Insurers of Last Resort"

One of CDI's major achievements has been curbing the withdrawal of admitted insurers from the California insurance market, which was forcing a substantial number of consumers into state residual markets.

When the insurance market is functioning properly, admitted insurers licensed by CDI provide coverage for most consumers. Because of problems with restrictive price regulation, affordability and capacity, however, admitted insurers might not always meet the demand for essential insurance products. The hope is that problems in the marketplace only exist temporarily and should disappear when market conditions change and improve. But, at those times when admitted insurers are not able to fulfill the demand, a residual market, often referred to as an "insurer of last resort" is established to satisfy the consumer's demand for essential insurance coverage.¹⁰

Usually a residual market is established for insurance coverage that is mandated by law, such as automobile liability coverage or workers' compensation insurance. Residual markets may also be created to provide consumers with insurance that are not state-mandated, but may be necessary for business transactions. For instance, lenders may require borrowers to obtain property insurance for vehicles or buildings and personal property to protect the creditor's collateral. In brief, a residual market is where you might have to turn if you cannot obtain the necessary insurance in other ways.

Although residual markets are a common mechanism to compensate for insufficient market competition, CDI has attempted to reduce consumers' dependence on the residual market. Efforts to encourage private insurers to compete for business in California has resulted in fewer individuals who are forced to rely on two of California's largest residual market programs: the **California Automobile Assigned Risk Plan (CAARP)** for auto insurance, and the **Fair Access to Insurance Requirements (FAIR) Plan** for urban risks and brush fire areas.

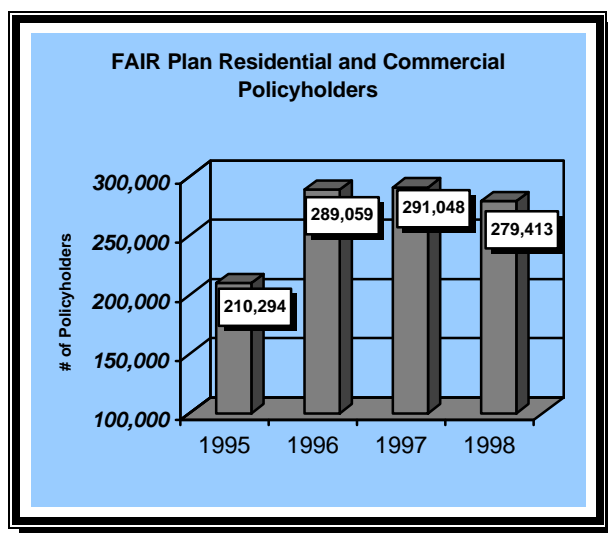
The FAIR Plan

The **California Fair Access to Insurance Requirements (FAIR) Plan Association** was created by statute in 1968 as an outgrowth of the 1961 Bel Air Canyon fires and the

1965 Watts riots.¹¹ At that time, there were concerns across the country that, because of the nature of risks inherent with the inner cities, persons living and operating businesses in urban areas would have difficulty obtaining insurance. Since 1968, the FAIR Plan has not only served as the "insurer of last resort" for urban risks, but also for areas prone to brush fire, because of the high risk and prevalence in California.¹² Programs similar to the FAIR Plan also exist in 29 other states and the District of Columbia to ensure that basic fire and, in some cases, extended coverage is available to property owners in urban areas.¹³

At the beginning of 1995, the number of policyholders in the FAIR Plan was climbing due to the crisis in homeowner insurance. CDI's efforts to resolve the homeowner crisis has resulted in a slight decrease in the number of participants in the FAIR Plan in 1998, as *Exhibit 10* indicates. According to the plan's Public Affairs Office, numbers for 1999 are expected to show a much more significant decline because the FAIR Plan is currently experiencing 1,100 per month net decline in the number of policyholders. The decrease in the number of FAIR Plan policyholders suggest that the private market is doing a better job of providing basic property insurance to urban areas, thus reducing dependence on the state's "insurer of last resort."

Exhibit 10: FAIR Plan Residential and Commercial Policyholders, 95-98



Source: California FAIR Plan Association, Public Affairs Office, April 15, 1999.

⁹ California Department of Insurance, Rate Regulation Branch, 1998.

¹⁰ Insurance Institute of America, *Surplus Lines Insurance Principles and Issues, 2nd Edition*, William R. Feldhaus, PhD, Coordinating Editor, and Doris Hoops, Coordinating Author, July 1997, page 61.

¹¹ California FAIR Plan Association, Public Affairs Office, April 15, 1999. The California FAIR Plan was created after the passage of the 1968 Federal Riot and Reinsurance Act.

¹² California Department of Insurance, memorandum dated April 14, 1999.

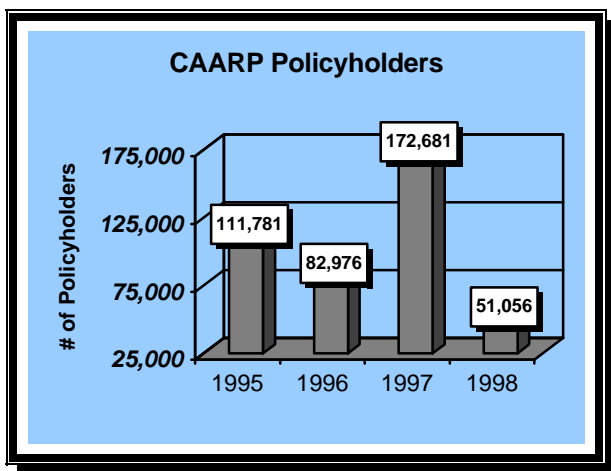
¹³ *Surplus Lines Insurance Principles and Issues*, page. 61.

The California Automobile Assigned Risk Plan

The California Automobile Assigned Risk Plan

(CAARP) was created in 1947 after a law was passed requiring all persons to provide proof of financial responsibility prior to obtaining a driver's license. As a consequence, a large number of "poor risk" drivers were unable to receive licenses to drive because insurers were not willing to assume the higher risks.¹⁴ Over 50 years later, CAARP still serves as the "insurer of last resort" for many Californians who are unable to obtain auto insurance in the private market. However, much improved and competitive market conditions are beginning to significantly decrease the number of California's consumers who cannot find affordable auto insurance from private insurers. *Exhibit 11* illustrates a substantial decline between 1995 and 1998 in CAARP policyholders, from 111,781 individuals in 1995 to 51,056 in 1998.

Exhibit 11: CAARP Policyholders, 95-98



Source: California Automobile Assigned Risk Plan, April 13, 1999.
Note: Statistics reflect private passenger non-fleet applications assigned.

The noticeable spike in the number of participants in 1997 can be attributed to the passage of AB 650, requiring drivers to carry proof of auto insurance. However, the private insurance market has been aggressively competing for business resulting in fewer policies written through CAARP. Additionally, insurers' private passenger auto liability rates have gone consistently down, making insurance generally more affordable for all consumers and lessening consumer dependence on this residual market.

¹⁴ California Department of Insurance, California Automobile Assigned Risk Plan Representative, April 13, 1999. See also *CSAA v. Maloney*, 71 S.Ct. 601, 602 (1951).